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STATE BOARD OF EQUALIZATION
STAFF LEGISLATIVE BILL ANALYSIS

Date Introduced:	**02/25/99**	Bill No:	**SB 818**
Tax:	**Sales and Use**	Author:	**Poochigian**
Board Position:		Related Bills:	

BILL SUMMARY:

This bill would, among other things, exempt from the 5 percent state sales and use tax, tangible personal property purchased by qualified persons primarily for use in post-harvesting activities of agricultural commodities, as specified and defined.

ANALYSIS:

Current Law:

Under existing law, a sales tax is imposed on retailers for the privilege of selling tangible personal property in this state. The use tax is imposed on the storage, use, or other consumption of tangible personal property purchased in this state. Either the sales tax or the use tax applies with respect to all sales or purchases of tangible personal property, unless that property is specifically exempted.

The rate of tax currently applicable to sales of tangible personal property is made up of various components:

- 5 percent state tax allocated to the state's General Fund (Section 6051).
- 1/2 percent state tax allocated to the Local Revenue Fund which is dedicated to local governments for program realignment (Section 6051.2).
- 1/2 percent state tax allocated to the Local Public Safety Fund which is dedicated to local governments to fund public safety services (Sec. 35 of the California Constitution).
- 1 1/4 percent Bradley-Burns Uniform Local Sales and Use Tax which is allocated to cities and counties (Part 1.5, commencing with Section 7200).
- 1/8 to 1 1/4 percent Transactions and Use Tax which is allocated to special taxing jurisdictions in various counties and cities within the state (Part 1.6, commencing with Section 7252).

Section 6377 of the Sales and Use Tax Law provides an exemption from the 5 percent *state* sales and use tax the sale and purchase of any of the following tangible personal property purchased for use in a new trade or business:

1) Property used by a qualified person, as defined, to be used primarily in any stage of manufacturing, processing, refining, recycling or fabricating.

2) Property primarily used in research and development by a qualified person.

3) Property primarily used to maintain, repair, measure or test any property described in (1) or (2).

4) Property sold to or purchased by a contractor for use in the performance of a construction contract with a qualified person, as specified.

Under the Personal Income Tax Law and the Bank and Corporation Tax Law, a 6 percent income tax credit on similar property is available to businesses who do not qualify as a new trade or business under Section 6377.

The Sales and Use Tax Law provides some exemptions related to the agricultural industry, as follows:

- Tax does not apply to the sales or purchase of any form of animal life or seeds and plants of a kind the products of which ordinarily constitute food for human consumption (e.g., sales or purchases of cows, bees, chickens, strawberry plants, and citrus seeds are exempt from tax).
- Sales or purchases of feed for "food" animals and fertilizer for "food" plants are exempt from sales and use tax.
- The sale and purchase of drugs and medicines administered to animals as additives to feed or drinking water are exempt if the primary purpose is to prevent and control disease of "food" animals.
- Other drugs and medicines, the primary purpose of which is the prevention or control of disease, that are administered to "food" animals are exempt.

Proposed Law:

This bill would:

1. Amend Section 6377 of the Sales and Use Tax Law to include within the 5 percent exemption, qualified property purchased for use in those lines of business described in Standard Industrial Codes (SIC) 0111 to 0291, inclusive, or SIC Code 0724.
2. Define "qualified property" as tangible personal property that is defined in Section 1245(a) of the Internal Revenue Code for use by a qualified person in those lines of business described in those specified SIC Codes, that is primarily used in connection with packaging, cold storage, or preparing of agricultural commodities.
3. Define "agricultural commodities" as products of California farms and ranches and items processed from these products, including forest products, aquacultural products, fish and fish products produced in California, and livestock fed in feedlots located in California.
4. Define "preparing" for purposes of the exemption to mean only those activities which, after an agricultural commodity has been grown and harvested, are required to prepare the commodity ready for manufacturing, processing or sale.

5. Define "tangible personal property that is primarily used in connection with cold storage of agricultural commodities" to include such things as compressors, pumps, fans and heat exchangers, but excluding the cold storage building itself or modifications made to those buildings.
6. Require purchasers of qualified property to be prequalified by the Board and to either be registered to hold a seller's permit or maintain a consumer use tax account.
7. Provide a tax credit for qualified property as defined, under the Personal Income Tax Law and the Bank and Corporation Tax Law.
8. Become effective immediately upon enactment, and would be repealed on January 1, 2005.

Background:

Similar bills have been introduced in the past to provide a partial sales and use tax exemption for agricultural-related equipment for new businesses. These are:

> AB 3089 (1994, Cannella) failed passage in the Assembly Revenue and Taxation Committee.
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> AB 208 (1995, Cannella), as introduced, passed out of the Assembly Revenue and Taxation Committee with the sales and use tax provisions amended out.
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> AB 2761 (1995, Poochigian) failed passage in the Senate Revenue and Taxation Committee.
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> SB 38 (1997, Johannessen) failed passage in the Senate Revenue and Taxation Committee.
>
> AB 138 (1997, Poochigian) was held in the Assembly Appropriations Committee.
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> AB 1063 (1997, Knox) as introduced, passed out of the Assembly Appropriations Committee with the sales and use tax provisions amended out.

COMMENTS:

1) Sponsor and Purpose. The author of this measure is the sponsor. The purpose of this bill is to extend the existing partial sales and use tax exemption for manufacturers to persons engaged in post-harvesting activities of agricultural commodities. Under the current classification system of the SIC Code Manual, the author's office points out that there are numerous borderline activities between manufacturing and other divisions of the classification system. There are some manufacturing-type activities performed by establishments, such as processing on farms, that are covered by other divisions under the current classification system and, consequently, do not fall within the current language of the exemption.

2) Types of establishments that would qualify for the exemption. This bill would expand the manufacturing exemption to include "qualified property" related to packaging, cold storage, or preparing of agricultural commodities. Agricultural commodities are described as products of California farms and ranches and items processed from these products. As drafted, the partial exemption would include only post-harvesting activities related to agricultural commodities. The SIC Codes referred to in the bill include the following industries:

   a) SIC Codes 0111 to 0291 – These codes include establishments primarily engaged in agricultural production, including, cash grains, other field crops, vegetables and melons, fruits and tree nuts, horticultural specialties, livestock, dairy, poultry, fish farms, chinchilla farms, bees, worms, and laboratory animals.

   b) SIC Codes 0274 – This code includes only establishments primarily engaged in cotton ginning.

3) Type of property qualifying for the partial exemption. The bill would exempt property primarily used in connection with packaging, cold storage, or preparing agricultural commodities (preparing is defined as activities *after* an agricultural commodity has been grown or harvested that are required in order to make the agricultural commodity ready for manufacturing, processing, or sale). The bill also references Section 1245(a) of the Internal Revenue Code for purposes of defining the property proposed to be exempted. Property defined in this section is essentially any property which is, or has been, subject to an allowance for depreciation *and* is either personal property, or other property such as certain single purpose agricultural or horticultural structures.

COST ESTIMATE:

Administrative costs would be incurred in developing computer programs, registering affected taxpayers, approving claimed exemptions, notifying retailers, amending Board regulations, and answering inquiries. An estimate of these costs is pending.

REVENUE ESTIMATE:

This bill would exempt machinery and equipment purchased by new businesses primarily for use in post-harvesting agricultural activities from a portion of the sales and use tax.

Background, Methodology, and Assumptions:

Based on a U. S. Department of Agriculture, Economic Research Service study on depreciation, the Franchise Tax Board estimated 1996 capital expenditures for machinery and equipment for post-harvesting agricultural processing to be $188 million.

This bill applies to new businesses only. Although there are no data that identify the portion of the above amount attributable to new businesses, that portion is likely to be quite small. (This would be consistent with the Board's experience with the sales tax exemption for new manufacturers enacted in 1993.) If one assumes that new businesses comprise only 1 percent of the total expenditures, then exempt purchases would be about $1.88 million annually.

Revenue Summary:

This bill calls for the exemption to apply to sales taxes resulting from the 5 percent State General Fund tax rate. The estimated annual loss is:

State General Fund	$94,000

Analysis prepared by:	Bradley E. Miller	445-6662	04/12/99
Revenue estimate by:	Jeff Reynolds	445-0840	
Contact:	Margaret S. Shedd	322-2376	

This staff analysis is provided to address various administrative, cost, revenue and policy issues: it is not to be construed to reflect or suggest the Board's formal position.